

STATE OF ARIZONA

Department of Revenue



Janet Napolitano
Governor

J. Elliott Hibbs
Director

August 4, 2004

Attached please find an Adobe PDF version of a proposed Arizona Transaction Privilege Tax Ruling on the imposition of transaction privilege tax or responsibility for use tax collection on sales of tangible personal property by out-of-state mail-order or Internet-based vendors. The ruling supersedes *Arizona Transaction Privilege Tax Ruling* TPR 94-12, which was rescinded on March 2, 2004. In an ongoing effort to interact with and inform the public regarding issues relating to taxation, the Department would appreciate your written comments on this document.

To view the file, you will need to have Adobe Acrobat Reader version 5.0 or higher (the current version is available for download at <http://www.adobe.com/products/acrobat/readstep2.html>). Hard copies of the proposed ruling are available upon request.

Please be advised that the deadline for comments or a request for extension of time for review is **Monday, September 6, 2004**. This office will review all comments that are received through this date and make any appropriate revisions before the Department issues the final ruling.

Please address your comments to:

Christie Comanita, Manager
Tax Policy & Research Division
Arizona Department of Revenue
1600 W. Monroe
Phoenix, AZ 85007
Fax: (602) 716-6791
E-mail: comanitac@revenue.state.az.us

Thank you for your continuing efforts to establish an ongoing line of communication with the Department of Revenue.

Sincerely,

/s/ Christie Comanita
Manager
Tax Policy & Research Division

Attachment

NOTICE

The Arizona Department of Revenue (ADOR) is circulating this proposed tax ruling for **informal review and comment** purposes only.

STATE OF ARIZONA

Department of Revenue



**ARIZONA TRANSACTION PRIVILEGE TAX RULING
TPR 04-__**

Janet Napolitano
Governor

(This ruling supersedes Arizona Transaction Privilege Tax Ruling TPR 94-12, rescinded March 2, 2004)

J. Elliott Hibbs
Director

ISSUE:

Imposition of Arizona transaction privilege tax or responsibility for use tax collection on sales of tangible personal property by out-of-state mail-order or Internet-based vendors.

APPLICABLE LAW:

Arizona Revised Statutes ("A.R.S.") § 42-5061(A) levies the transaction privilege tax on the retail classification. The retail classification is composed of the selling of tangible personal property at retail.

A.R.S. § 42-5155(A) levies the use tax on the storage, use, or consumption in this state of tangible personal property purchased from a retailer, as a percentage of the sales price.

A.R.S. § 42-5160 provides that "every retailer and utility business maintaining a place of business in this state and making sales of tangible personal property for storage, use, or other consumption in this state shall collect the tax from the purchaser or user unless the property is exempt under this article or the purchaser or user pays the tax directly to the department as provided by section 42-5167."

A.R.S. § 42-5161 provides that "except as provided by § 42-5167, every retailer and utility business shall collect from the purchaser the tax imposed by this article and give to such purchaser a receipt for the tax in the manner and form prescribed by the department. The tax required to be collected shall be shown separately on the invoice or other proof of sale. The tax required to be collected shall constitute a debt owed by the retailer or utility business to this state."

LEGAL REFERENCES:

Quill Corp. v. North Dakota, 504 U.S. 298 (1992).

Tyler Pipe Industries, Inc. v. Washington State Department of Revenue, 483 U.S. 232 (1987).

National Geographic Society v. California Board of Equalization, 430 U.S. 551 (1977).

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1 *Scripto v. Carson*, 362 U.S. 207 (1960).

2 *Arizona Department of Revenue v. Care Computer Systems, Inc.*, 4 P.3d 469 (Ariz. Ct.
3 App. 2000).

4 *Arizona Department of Revenue v. O'Connor, Cavanagh, Anderson, Killingsworth &*
5 *Beshears, P.A.*, 963 P.2d 279 (Ariz. Ct. App. 1997).

6 **DISCUSSION:**

7 This ruling addresses whether the imposition of Arizona transaction privilege tax or
8 responsibility for use tax collection will apply to sales of tangible personal property by an
9 out-of-state retailer making sales to Arizona customers.

10 The United States Supreme Court held that “physical presence” with the taxing state is
11 required for a business to have “substantial nexus” with the state and thereby allow it to
12 constitutionally impose its use tax collection requirement.¹ Over the years, the Court has
13 held that physical presence exists if a taxpayer maintains real property or personal property
14 within the state, or when the taxpayer has employees or agents acting on its behalf within
15 the state.

16 The Court has held that a salesman’s designation as an “independent” contractor does not
17 change his local function or bear upon a retailer’s ability to secure its flow of goods into the
18 forum state.² Nexus cannot be avoided through use of an employee-independent
19 contractor distinction.

20 The Arizona Court of Appeals has recognized that the crucial factor governing nexus is
21 whether the activities performed in the taxing state on behalf of the taxpayer are
22 significantly associated with the taxpayer’s ability to establish and maintain a market in the
23 state for its sales.³

24 Arizona case law has held that transaction privilege tax imposed under the retail
25 classification does not require a higher level of nexus with the taxing state than use tax.⁴ If
26 a taxpayer maintains the required degree of nexus with Arizona, the taxpayer will be
27 subject to transaction privilege tax rather than a use tax collection obligation, unless
28 otherwise provided by statute.

29 The requisite nexus for a taxpayer to be subject to transaction privilege tax liability does not
30 require a physical place of business within the state.⁵

31 The presence of a vendor’s real property within a taxing state need not be related to the

¹ *Quill*, 504 U.S. at 312-17.

² *Scripto*, 362 U.S. at 211.

³ *Care Computer*, 4 P.3d at 471 (quoting *Tyler Pipe*, 483 U.S. at 250).

⁴ *Id.*

⁵ *Id.* at 474.

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activity the state seeks to tax in providing nexus to impose an obligation upon the vendor to collect use tax.⁶

Arizona use tax functions as a complement to transaction privilege tax: if transaction privilege tax applies, use tax does not.⁷ In *Arizona Department of Revenue v. O'Connor, Cavanagh, Anderson, Killingsworth & Besears*, the Arizona Court of Appeals held that the Department of Revenue could have imposed transaction privilege tax on the out-of-state vendor and thus could opt not impose use tax instead on the in-state purchaser.⁸

RULING:

An out-of-state vendor's sales to an Arizona resident are subject to Arizona transaction privilege tax if:

1. The out-of-state vendor has employees, representatives, or agents in Arizona for the purpose of soliciting orders, repair, installation, warranty work, or any other activity connected to the goods sold.
2. The out-of-state vendor maintains real or personal property in Arizona related to the goods it sells.
3. The out-of-state vendor *associates* an in-state vendor in its transactions.

Although it is not an exhaustive list, association would occur by: having the out-of-state vendor ship directly to the in-state vendor; having the in-state vendor complete any installation of the purchased goods; having the in-state vendor exchange damaged goods from its own inventory; or allowing the customer to return the product to the in-state vendor's business location.

Many large retailers operate Internet websites that allow purchases of the same items sold by an in-state physical location. These websites are either owned by the retailer or owned by a related entity. Should the Internet vendor allow returns or exchanges to be made at the in-state location, allow coupons from its website to be redeemed at the in-state location, or use the in-state entity as its agent in any transaction, all of the Internet vendor's sales to Arizona customers will be subject to Arizona transaction privilege tax.

An out-of-state vendor's sales are subject to use tax collection if the out-of-state vendor maintains a business in the state that is completely disassociated from the out-of-state vendor's sales, which means that this business does not foster and establish a market for the taxpayer's sales.

RATE: An Internet or mail-order retailer shall charge, collect, and remit Arizona transaction privilege or use tax based on the rate in effect at the *customer's* location.

⁶ *Nat'l Geographic*, 430 U.S. at 560-61.

⁷ *O'Connor*, 963 P.2d at 283-87; *see also* A.R.S. § 42-5159(A).

⁸ *Id.*

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The following examples illustrate situations in which transaction are subject to either Arizona transaction privilege or a use tax collection requirement:

1. *Facts:* X is an Internet or mail-order retailer that also operates a retail store in Arizona selling the same items. Purchasers send orders by mail or over the Internet to X's out-of-state address. Merchandise is shipped directly from the out-of-state warehouse to purchasers in Arizona.

Result: X is required to pay transaction privilege tax on its sales based on the presence of related real property within the state.

2. *Facts:* X is an Internet or mail-order retailer that does not operate a retail store in Arizona. Z, in Internet customer, purchaser an item from X's website. The item is shipped in a damaged condition. X allows its customers to return damaged goods to a local retail store owned by Y. Y is an entity related to X that sells items identical to X and maintains physical retail locations in Arizona. Z, and all Arizona customers, can utilize the local retail stores to replace damaged items.

Result: X's agreement with Y to act as its agent for customer returns creates nexus for the imposition of transaction privilege tax on X's Internet sales. Even though the item is mailed directly to Z from the retailer's out-of-state location, X is subject to transaction privilege tax on the sale.

3. *Facts:* X is an Internet or mail-order retailer that does not operate a retail store in Arizona. X maintains a hotel or restaurant in Arizona that does not make any retail sales.

Result: Although X maintains real property in the state, it is disassociated with X's market for retail goods. In this instance, X is liable for use tax collection on its Internet or mail order sales and not transaction privilege tax.

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to Department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.